3-1-1982

Management Implications of the Economic Recovery Tax Act of 1981

George Patrick

EC-565

Management Implications of the Economic Recovery Tax Act of 1981

by George Patrick
Extension Economist

The Economic Recovery Tax Act of 1981 brings major changes in income tax, estate and gift tax provisions, and in tax incentives for savings and investment. Some provisions dealing with the estate and gift tax are retroactive to 1977. Only some parts of the law apply to the 1981 tax year. Much of the law becomes effective in the 1982 tax year or in later years. This publication discusses changes in the tax laws and management implications for farmers.

This publication is divided into four major sections. Changes affecting individuals are discussed first. Second are some of the business provisions of the 1981 Tax Act. Corporate changes, which affect a small number of farmers, are discussed third. Some of the estate and gift tax changes are discussed in the fourth section. Many of the rules and regulations are still being written by the Internal Revenue Service. Additional analysis will be necessary to see how some of these changes can affect your individual farming operation.

CHANGES AFFECTING INDIVIDUALS

Tax Rates

The 1981 Tax Act reduces individual income tax liability in stages. The first cut in the tax rate occurred October 1, 1981 and was equal to 5 percent. However, because this cut only applies to the last 3 months of 1981, it is only equal to a tax reduction of 1.25 percent for the entire year. On July 1, 1982 taxes will be reduced by an additional 10 percent, and then there will be a third reduction of 10 percent on July 1, 1983.

The income tax rates, the zero bracket amount and personal exemptions will be indexed for inflation after 1984.

The effect of the tax rate reduction is shown in Table 1 for families of four with incomes of $20,000 and $40,000. For both income levels, taxes in 1984 will be about 23 percent lower than in 1980. In 1980, the marginal income tax rate for the $20,000 was $.24 on an additional $1.00 of income. For 1984, the marginal income tax rate will be reduced to 18 percent. For the $40,000 income level, the marginal income tax rate will be reduced from 43 percent in 1980 to 33 percent in 1984.

Income in future years will be taxed at lower rates. To save on taxes, the general strategy should be to shift income into future years. Increase deductions where possible in 1982 and delay receipts until 1983 unless you are in a low income tax bracket in 1982. Farmers with below normal incomes in 1982 may save on taxes by postponing expenditures until 1983 when they expect to have a higher level of taxable income.

Maximum Tax Rates

On January 1, 1982 the highest marginal tax rate on an individual was cut to 50 percent on all types of income. This is a reduction from the 1981 maximum rate of 70 percent. The special maximum tax rate of 50 percent which generally applies to personal services or earned income such as wages, salary, and professional fees was repealed January 1, 1982. This will help avoid problems of some high income farms in allocating farm income to capital and personal services. This change may also reduce the attractiveness of some tax shelters.

Capital Gains

The tax on long-run capital gains has been reduced to a maximum rate of 20 percent on sales after June 9, 1981. Individual taxpayers are allowed to deduct 60 percent of their net capital gain for the taxable year from their gross income. The remaining 40 percent of the net capital gain is included in gross income and is taxed at the regular rates applicable to the taxpayer. For the 1981 tax year, the highest

Table 1. Taxes and savings relative to 1980 for selected income[a]

Year	$20,000 income: Income taxes	Savings relative to 1980	$40,000 income: Income taxes	Savings relative to 1980
1980	$2265	—	$8495	—
1981	$2243	$ 22	$8410	$ 85
1982	$2013	$252	$7635	$ 860
1983	$1846	$419	$6904	$1591
1984	$1741	$524	$6538	$1957

[a] *Calculations assume a family of four filing a joint return and using the zero bracket amount.*

individual rate is 70 percent, which would make the tax rate on high income individuals net capital gain 28 percent. The 1981 Tax Act reduces the ceiling rate from 70 to 50 percent after 1981. A special provision reduces the effective rate on capital gains from 28 to 20 percent on sales after June 9, 1981.

Individuals in the 50 percent or higher tax bracket will get the benefit of the new maximum tax rate on capital gains whether property is sold in 1981, in 1982 or later years. However, taxpayers in a less than 50 percent tax bracket may wish to change strategy with respect to taking capital gains. As indicated above, individual tax rates will drop in 1982 so that the capital gains will be taxed at a lower rate next year for those in lower tax brackets. For example, a married couple with a taxable income of $30,000 would be in the 37 percent bracket in 1981 and 33 percent bracket in 1982. Only 40 percent of capital gains is taxable; therefore, the tax on capital gains will be 37 percent times 40 percent equal to 14.8 percent of the total gain in 1981 as compared with 33 percent times 40 percent or 13.2 percent in 1982. Similar considerations also apply to 1982 and later years.

Sale of a Residence

An individual selling a principal residence after July 20, 1981 has 2 years to replace it without being taxed on the gain; this extends the rollover period from the previous 18 months. An individual who sold a home and was still within the 18-month rollover period on July 20, 1981 gains an additional 6 months in which to replace the home without being taxed on the gain. Generally, if an individual over 55 sells a principal residence and does not replace it or replaces it with a residence of lesser value, a once-in-a-lifetime exclusion on the gain of $125,000 can be taken. This applies if the principal residence is sold after July 20, 1981 and increases the exemption from the $100,000 previously allowed.

Savings Incentives

One of the major objectives of President Reagan's tax program was to create incentives for individuals as well as businesses to increase savings and investments. In 1981, an individual may exclude $200 ($400 on a joint return) of dividend and interest income, but in 1982 only $100 dividend exclusion ($200 on a joint return) will be allowed. The new law also provides for some special exclusion on interest beginning in 1985.

The 1981 Tax law provides a one-time exclusion from gross income of $1,000 ($2,000 on a joint return) on interest which is earned on qualified tax exempt savings certificates. Commonly called "All-Savers Certificates," these are issued after September 30, 1981 and before January 1, 1983 by a qualified depository institution. All-Saver Certificates have a yield equal to 70 percent of the investment yield on 52-week Treasury bills. Interest earned on these All-Savers Certificates up to the limit is excluded from gross income and is therefore tax free. To qualify for the exclusion, the certificate must meet a number of regulations. In addition, an individual must meet certain qualifications to exclude the income. The interest paid on qualified certificates is excluded only when earned by individuals or when included in an estate of an individual owner. All-Savers Certificates have a maturity of one year. If the certificate is cashed in early, the tax exemption is lost and there is a penalty on the interest earned. Certificates cannot be used as collateral for loans.

An individual can compare the yield of the tax-free certificate with taxable investments as follows:

$$\frac{\text{All-Savers Certificates Tax-Free interest rate}}{1-\text{Marginal tax rate in 1982}} = \text{Breakeven rate of interest on taxable investments}$$

For example, for an individual in the 30 percent tax bracket, the initial 12.61 percent return on the All-Savers Certificates was equivalent to a breakeven rate of 18.01 percent on taxable investments.

$$\frac{.1261}{1-.30} = .1801$$

The amount of money which can be deposited to earn the amount of intrerest which can be excluded is calculated as follows:

$$\frac{\text{Interest limit (\$1,000-single, \$2,000-married filing jointly)}}{\text{Interest rate on certificate}} = \text{Amount to deposit in "All-Savers" Certificates}$$

For example, a single individual must invest $7,930.21 at the 12.61 percent rate to receive $1,000 in interest.

$$\frac{\$1,000}{.1261} = \$7,930.21$$

To benefit from investments in the All-Savers Certificate, an individual generally should be in a relatively high tax bracket. The yield on an All-Savers Certificate is 70 percent of the average yield of one-year Treasury bills. Therefore, individuals in the 30 percent or higher tax brackets will generally benefit from an investment in the All-Savers Certificate. It is the 1982 tax rate which will apply when an individual is calculating whether to invest in an All-Savers Certificate. To be in the 30 percent tax bracket in 1982, a married couple filing a joint return would have to have a taxable income of about $30,000. The taxable income would be the gross income minus the $1,000 exemption per each plus any itemized deductions above the zero bracket amount. For a single individual in 1982, a taxable income exceeding $18,000 would be in the 30 percent or higher bracket.

The All-Savers Certificate may represent a good investment for individuals in tax brackets below 30 percent because of the initial minimum investment being only $500. Although these individuals might gain a higher after-tax return by investing in money market funds or certificates of deposit, the initial investment required may be greater than they can make.

Marriage Penalty Reduced

The 1981 Tax Recovery Act attempts to reduce the additional tax which some married couples pay by filing a joint return rather than being able to file as single individuals. There is no adjustment for the 1981 tax year. In 1982, a two-income family can reduce their gross income by 5 percent of the lesser income up to a maximum income of $30,000. For example, if one spouse earns $20,000 and the other earns $25,000, they can reduce their gross income of $45,000 by $1,000 (5 percent of $20,000) to $44,000 for tax purposes. In 1983, the reduction is 10 percent of the lesser earned income up to a maximum income of $30,000. The effect of this income exclusion is to reduce somewhat the so-called "tax penalty" associated with some married individuals filing a joint return.

Child Care Credit

For 1981 tax purposes, an individual can claim a 20 percent credit on child care expenses up to $2,000 for one qualifying individual or $4,000 for two or more individuals. The maximum credit is $400 or $800 for one and two or more individuals, respectively. In other words, if $2,400 is spent on babysitting for a child so that an individual could work, a credit of 20 percent of the first $2,000 (for a maximum—$400) against the amount of tax that they owe could be claimed. In 1982 these limits increase to $2,400 for one individual and $4,800 for two or more individuals. There is also a change in the amount which can be deducted. For an individual whose income is less than $10,000, 30 percent of the expense can be deducted. This 30 percent decreases by 1 percent for each $2,000 of additional income until the credit is reduced to 20 percent at the $30,000 income level.

Maximum Rate of Imputed Interest

For unrelated parties, the law specifies that if the contract does not provide at least a 9 percent rate of interest, then a 10 percent rate will be imputed on installment sales.

The 1981 Tax Act sets a maximum of 7 percent of imputed interest on qualified sales of land among related parties unless the contract specifies a higher rate of interest. Qualified sales such as from parents to children, between brothers, sisters, or other close relatives can be eligible for this lower imputed rate. The special 7 percent rate is limited to the first $500,000 of sales or exchanges in one year. This rate is effective only for contracts entered into after June 30, 1981.

Retirement Programs

The 1981 Tax Act makes major changes in the individual retirement programs available for farmers and other businessmen. For tax years beginning after 1981, an individual can participate in an Individual Retirement Account (IRA) whether the individual was active in a qualified employer or government plan. The amount an individual contributes to a qualified plan can be subtracted from the gross income. The annual limit on contribution to any IRA is the smaller of the following amounts: a) $2,000 or b) 100 percent of the individuals annual earned income. This is an increase from the $1,500 or 15 percent limitation which applies to 1981.

A farmer who works in an off-farm job and is covered by a qualified retirement program can have his own individual program. The money contributed to this retirement account is not includable in income for tax purposes. In 1982, an individual can increase the amount paid to an IRA for a nonworking spouse. The maximum allowable as a deduction to a taxpayer filing a joint return may not exceed the lesser of $2,250 or 100 percent of the individual's compensation for the year. The maximum allowable as a spousal deduction must be reduced by the amount allowed as the deduction for the contributions to an individual's own IRA. The contribution to either the taxpayer or spousal IRA may not exceed $2,000 annually. An employed or self-employed spouse can establish his own IRA.

Self-employed individuals who are covered under an H.R. 10 or Keogh plan may contribute an amount equal to the lesser of $15,000 or 15 percent of the individual's net earnings from self-employment for the year. This contrasts to a maximum in 1981 of the lesser of $7,500 or 15 percent of the earnings from self employment. After 1981, a participant in an H.R. 10 plan may also make a contribution to an IRA within the rules discussed above.

Simplified Employee Pension plans (SEP) have also been changed by the 1981 Tax Act. A SEP plan is essentially an IRA to which an employee and the employer both may contribute. The employee must include any employer contributions in gross income but is allowed an offsetting deduction. The employer's contribution to a SEP is governed by the same contributions limitation that applies to an H.R. 10 plan. The employee's contributions are governed by the IRA limits on contributions. After 1981, an employee for whom an employer contributes under a SEP is considered an active participant in a qualified employer plan and is free to make IRA contributions within the rules discussed previously. The employer's SEP contribution limitations increase to the 15 percent or $15,000 limit applicable to H.R. 10 plans.

In general, many farmers have not participated in individual retirement programs. In many cases they have alternative uses of money which they felt would yield higher returns, and this made economic sense. However, older farmers, those approaching retirement age, may wish to establish IRAs or Keogh plans to shelter income from current taxes. Contributions to retirement plans are taxable after retirement, at presumably lower rates. Earnings on retirement plans also accumulate and are not taxed until withdrawn. Gradually, one IRA can be "rolled over" into another IRA without penalty or tax to obtain a higher rate of return.

A farmer whose spouse works on the farm may wish to pay the spouse a salary. Payments for work done by a spouse are not subject to Social Security tax, but do reduce the income reported by the farmer for self-employment tax purposes. The salary paid to the spouse can be put into an IRA, avoiding both the self-employment tax and income tax. A couple could contribute up to a total of $4,000 per year to their IRAs.

Futures Contracts

Farmers and others speculating in commodity futures contracts must treat a futures contract as if it had been sold on the last business day of the year. "Hedging" transactions are not affected by the new law. Gains or losses on hedging transactions are treated as ordinary income. Many farmers "hedge" on the futures market and will not be affected.

The "mark-to-market" rule will apply to speculative positions taken after June 23, 1981. The "mark-to-market" accounting process adds or subtracts the gains or losses on a commodity contract each day. A speculator may have a paper profit or may need to "meet a margin call." At the close of an individual's taxable year, typically December 31, a speculative futures contract will be treated as if it were sold (purchased for short positions). Any gain or loss will be recognized and treated for tax purposes as follows:

1. Forty percent of the gain or loss will be short-term capital gain or loss.
2. Sixty percent of the gain or loss will be long-term capital gain or loss.

These gains or losses will be combined with other gains or losses on futures transactions during the year to determine the net commodity futures gain or loss. Net commodity gains, if any, are combined with other capital gains in computing income. Net commodity futures losses can be carried back to affect net commodity futures gains in the previous 3 years, but not before 1981. Net commodity futures losses that are not carried back, are carried forward and can offset net commodity futures gains in future years. A number of special rules affect what is carried back or carried forward. Even more complicated rules apply to straddles and mixed straddles.

Speculators should consult their tax advisers to determine how these rules may affect them.

BUSINESS TAXES

Accelerated Cost Recovery System

The Economic Recovery Tax Act of 1981 made major changes in the alternatives available to farmers and other businesses to recover costs in depreciable assets. For assets placed in service before 1981, the old rules and regulations with respect to depreciation and investment credit will continue. However, for investments placed in service any time in 1981, or in later years, the new cost recovery rules will generally apply.

The Accelerated Cost Recovery System (ACRS) is the new method for the recovery of capital costs for most depreciable property placed in service after 1980. The cost recovery methods are the same for both new and used property. Salvage value of property is not considered. Farmers and other businesses generally must use either the ACRS straight-line or percentage method of depreciation. The latter is a combination of depreciation methods which will generally give the most rapid cost recovery.

Depreciable personal property is placed in three recovery period classes. Three-year property includes autos, pick-ups, light duty trucks, breeding sows and boars, race horses over 2 years of age and any other horses over 12 years of age. Five-year property includes most agricultural machinery and equipment, heavy-duty trucks, cattle used for breeding or dairy, and horses (other than race horses) less than 12 years of age. This class also includes depreciable personal property eligible for investment credit. Illustrations are fences, grain bins, silos, drainage tile, feed bunks, paved yards, and wells. Single purpose agricultural and horticultural structures are also included in the 5-year category. Ten-year property is not common in agriculture. One example is a mobile home used for housing hired labor or as a farm office. Depreciable real property is placed in a 15-year recovery class.

A farmer who places cost recovery property in service after 1980 may elect to recover the cost of this depreciable asset by using either the ACRS percentages, which are developed for each class of property, or a modified straight-line method. The ACRS percentage for depreciable personal property is indicated in Table 2. This Table automatically allows a taxpayer 6 months of cost recovery in the year of purchase, whether the purchase was in January or December.

The modified straight-line method also allows the farmer to take one-half year of cost recovery the first year regardless of when the machine is placed in service. One-half year of cost recovery is also taken in the year following the normal end of the cost recovery period. For example, if an individual elects a 5-year straight-line recovery method, then a 10 percent cost recovery can be taken the first year. A cost recovery of 20 percent annually can be taken in years 2 through 5, and the remaining 10 percent in year six. The 15-year real property has cost recovery calculated on a monthly basis.

Optional cost recovery periods for the straight-line methods are:

3-year personal property	3, 5 or 12 years
5-year personal property	5, 12 or 15 years
10-year personal property	10, 25 or 35 years
15-year real property	15, 35 or 45 years

If a farmer buys a number of assets in a particular recovery class during a tax year, all of these assets must be treated the same. For example, if a farmer buys a tractor and a combine in one year, the same cost recovery method and period must be used for both assets.

Table 2. Percent recovery deduction by year for recovery class of personal property[a]

Recovery year	Recovery period/Class of personal property 3-year	5-year	10-year
		Percent	
1	25	15	8
2	38	22	14
3	37	21	12
4	—	21	10
5	—	21	10
6	—	—	10
7	—	—	9
8	—	—	9
9	—	—	9
10	—	—	9

[a] *This table applies to assets placed in service from January 1, 1981 to December 31, 1984. Other tables will apply for 1985, 1986 and later years.*

Use of the ACRS method is not permitted on assets acquired from a close relative or on assets which were used by the taxpayer in 1980. In these cases, the old depreciation options will apply.

In general, farmers will find it to their benefit to recover the cost as rapidly as possible using the ACRS percentage method. Farmers may wish to use the straight line method of cost recovery and optional recovery periods if income in future years is expected to be considerably higher.

Expensing Depreciable Purchases

The 1981 Tax Act allows farmers and other businessmen to "expense" (deduct the cost in the year of purchase) up to $5,000 of depreciable property purchased in tax years 1982 and 1983. In 1984 and 1985 this will increase to $7,500 and $10,000 in tax years after 1985. The amount of an asset which a farmer expenses is *not* eligible for investment credit. In many cases, this means that a farmer is probably going to minimize taxes by claiming the investment credit and taking cost recovery allowances rather than expensing the purchase.

Investment Credit Changes

Farmers and other businessmen now receive the full 10 percent investment credit on assets with a cost recovery period of 5 years or more. For investments with a 3-year cost recovery period, a 6 percent credit is earned. The applicable percentage is determined by the recovery period class to which the asset belongs, *not* the period the farmer uses for cost recovery.

Recapture provisions are also changed for assets placed in service in 1981 and later years. For assets purchased after 1980, investment credit is essentially earned at the rate of 2 percent per year. In other words, if a piece of 5-year property is sold after having been used for 3 years, it would have earned 6 percent rather than 10 percent investment credit.

Corporate Income Tax Rates

For tax years beginning after 1981, the tax rates applying to regular (or Sub-chapter C) corporations will be reduced. For a corporation with a taxable income of less than $25,000 the rate will be reduced from 17 percent in 1981 to 16 percent in 1982 and then to 15 percent in 1983 and later years. For a corporation with a taxable income of $25,000 to $50,000, the rate will be reduced from 20 percent in 1981 to 19 percent in 1982 and 18 percent in 1983 and later years. There is no reduction in the corporate income tax rates for taxable incomes of over $50,000.

Changes in the corporate income tax rate are less than those changes in the rates for individuals because corporations are presumed to get greater benefits from ACRS. The reduction in individual tax rates will reverse the trend of high income farmers to incorporate their farms as regular corporations. As before, farmers may wish to incorporate as a family or Sub-chapter S corporation for other reasons.

Sub-Chapter S Corporation

Beginning in 1982, Sub-chapter S corporations are permitted to have 25 shareholders rather than the 15 shareholders allowable previously.

Rehabilitation Investment Tax Credit Changes

The investment credit allowed for the rehabilitation of certain buildings has been substantially modified for 1982 and later years. In 1981 the 10 percent investment credit was available for expenditures to rehabilitate a building which was at least 20 years old. The 1981 Tax Act modifies this, and the investment credit percentages will vary depending upon the building's age. For buildings that are 30 to 39 years old, the credit will be 15 percent of the expenditures. For buildings that are at least 40 years old, investment credit will increase to 20 percent, and a 25 percent investment tax credit will apply for certified historic buildings.

Farmers should note that buildings in the 20 to 30-year-old category will *not* be eligible for the rehabilitation credit after 1981.

Forms 1099-MISC, 1099-INT, and 1099-NEC

A penalty of $10 will be assessed by the IRS for the failure to file a Form 1099-MISC, Form 1099-INT, or Form 1099-NEC. These are information returns and are required if you make business payments of $600 or more in a year to individuals who are not your employees. Interest payments to an individual of $600 or more are reported on Form 1099-INT. Cash rents and other payments that are not for services are reported on the 1099-MISC. Payments for merchandise, freight and similar charges need not be reported. Form 1099-NEC is used for payments of $600 or more for fees, commissions and other services paid to persons who are not your employees: custom work, independent contractors, attorney, veterinary, and accountant fees are examples. A copy of the Form 1099 must be filed with the IRS and a copy should be given to the person who received payment from you. Form 1099 is not required for payment to a corporation.

Farmers who receive a Form 1099 should identify this income on their tax returns to avoid inquiries from the IRS.

ESTATE AND GIFT TAX CHANGES

Changes in the estate and gift tax provisions through the Economic Recovery Tax Act of 1981 have been extensive. Some of the changes are outlined below. Although helpful, these changes have not solved the estate problems for all people. Individuals should review their estate planning carefully in view of the changes enacted.

Unified Credit

The 1981 Tax Act increases the unified federal estate and gift tax credit from the 1981 of $47,000 to $192,800 in 1987 and later years. This is a unified credit available to offset federal taxes on gifts during life or federal estate tax on property passing at death. The current credit of $47,000 is equivalent to a deduction of $175,000 and the 1987 credit is equivalent to a deduction of $600,000. Estate tax returns must be filed only when the value of the estate exceeds the amounts in Table 3.

Although the increase in the unified credit is substantial, current rates of inflation make the increased deduction rather deceiving. If inflation occurs at a rate of 12 percent annually for the next 6 years, the value of an estate could approximately double during the period. Continued inflation could cause the reduction in estate taxes to be less than expected by many people.

New Tax Rates

The maximum tax rate on estates is reduced by a phase-in process from 70 to 50 percent. For deaths in 1981, the maximum rate is 70 percent for transfers over $5,000,000. For 1985 and later years, the maximum rate is 50 percent for estates over $2,500,000. The rates for 1985 will effectively range from 37 to 50 percent. The tax rate structure for transfers below $2,500,000 will not be changed, but larger estates will become exempt between now and 1987 because of the increase in the unified tax credit.

Marital Deduction

After 1981, essentially all transfers between spouses are nontaxable and are not subject to either gift or estate tax. The marital deduction for estate and gift tax purposes is unlimited after 1981.

Current wills or trusts which use the maximum marital deduction formula clauses should be reviewed and amended if necessary.

The 1981 Tax Act also modified the definition of property qualifying for the marital deduction. Under the 1981 Law, certain life income interests such as legal life estates or life income interest in a trust may qualify for the marital deduction if the donor or the decedent's executor so elects. A "qualifying income interest" must meet several conditions, but does provide flexibility in estate planning.

Jointly-owned Property

For deaths after 1981, one-half the value of the joint tenancy property will be included in the estate of the first joint tenant to die if this property is owned by spouses and only by the spouses. Only one-half the value will receive a stepped-up basis for income tax purposes.

This change avoids the "consideration furnished" test which caused difficulties for many farm couples. However, because of joint tenancy ownership, the entire jointly-owned property will pass to the surviv-

Table 3. Unified credit and equivalent deduction for federal estate and gift taxes

Year	Unified credit	Equivalent deduction
1981	$ 47,000	$175,000
1982	62,800	225,000
1983	79,300	275,000
1984	96,300	325,000
1985	121,800	400,000
1986	155,800	500,000
1987 and later	192,800	600,000

ing spouse. Potentially this can cause an estate tax problem for the survivor. The unlimited marital deduction in 1982 and later years allows spouses to equalize estates without paying any gift tax.

Gifts

The current limit of $3,000 gift exclusion is increased to $10,000 per person per year for gifts after 1981. If a husband and wife elect to "split" gifts, it is effectively $20,000 per person per year.

Taxable gifts (nonmarital, split gifts and gifts in excess of $10,000 per person per year) will need to be reported on gift tax returns. These returns will be reported on a calendar year basis and are due by April 15 the following year.

Under the 1981 Tax Act, gifts of property within 3 years of death (with several exceptions) are not brought back into the estates of individuals dying after 1981.

Installment Payment of Estate Tax

The 1981 Tax Act liberalized provisions by which the estate of an individual dying after 1981 could qualify for the 15-year installment payment of federal estate taxes. For deaths after 1981, a closely-held business need exceed only 35 percent of the adjusted gross estate instead of 65 percent. Up to 50 percent, rather than one-third, of the closely-held business can be distributed, sold, exchanged or otherwise disposed of or withdrawn from the business without the remaining installments becoming due. Late payments, up to 6 months after the due date, no longer terminate installment reporting.

The 4 percent interest rate, together with the liberalized provisions, makes installment payment of estate taxes an attractive option.

Special "Use" Valuation of Land

The 1981 Tax Act makes a number of changes in the interpretation of the "use" valuation of land for estate purposes which generally favor farmers. The limit on the amount of the reduction in the value of the estate possible from use valuation was increased for $500,000 to $600,000 for 1981. This increases to $700,000 for 1982 and to $750,000 for 1983 and later years. Late filing of the estate tax return will not bar special "use" valuation.

The material participation required for at least 5 of the 8 years prior to the property owner's death has been changed for a retired or disabled person. Material participation must have occurred 5 of 8 years prior to retirement or disability. "Active management" can meet the qualified use requirement and will satisfy the material participation requirement after death. There is a 2-year grace period after death in which the property need not be used by a qualified heir in a qualified use. One qualifying heir can purchase an interest from another heir and this is treated as if the purchase had been from the decedent.

Other changes have also been made to facilitate utilization of the "use" valuation provisions. Use of share rents can be used if cash rent data are not available. Like-kind exchanges and "tacking" of holding periods are permitted. As a result of these and other changes, the business management difficulties associated with election of special use valuation are reduced.

Useful References

Internal Revenue Service Publication 225, *Farmer's Tax Guide,* revised annually and available through the IRS, county extension offices and many banks.

Internal Revenue Service Publication 17, *Your Federal Income Tax,* revised annually and available through the IRS. The toll-free number for Indiana is (800) 382-9740.

Harl, Neil, *Farm Estate and Business Planning,* (7th edition) Agri Business Publications, Inc., 5520-G Touhy Avenue, Skokie, Illinois 60077 ($12.95).

O'Byrne, John C. and Charles Davenport *Tax Guide for Farmers,* (1981 edition) Doane Agricultural Service, Inc., 8900 Manchester Road, St. Louis, Missouri 63144 (approximately $13).

This article is intended to provide a general overview of the 1981 Economic Recovery Tax Act and management guidelines for farmers.
For advice concerning a specific tax situation, an individual should consult a competent tax advisor.
Appreciation is expressed to Bob Suter, Ed Carson and Don Pershing for helpful comments on an earlier version.

NEW 3/82

Cooperative Extension Work in Agriculture and Home Economics, State of Indiana, Purdue University and U. S. Department of Agriculture Cooperating. H. G. Diesslin, Director, West Lafayette, IN. Issued in furtherance of the Acts of May 8 and June 30, 1914. It is the policy of the Cooperative Extension Service of Purdue University that all persons shall have equal opportunity and access to its programs and facilities without regard to race, color, sex, religion, national origin, age or handicap.